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IN THE

Supreme Court of the United States

OCTOBER TERM, 1945.

No. 754

W. P. SEWELL AND R. B. SEWELL, *Petitioners*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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To the Honorable, the Supreme Court of the United States:

W. P. Sewell and R. B. Sewell respectfully pray for a writ of certiorari to review the judgment of the Circuit Court of Appeals for the Fifth Circuit, entered in the above entitled case. Since for present purposes the cases of the two Petitioners are identical, we shall, for simplicity, refer only to the case of W. P. Sewell, whom we shall refer to as Petitioner.

OPINION BELOW.

The opinion of the Circuit Court of Appeals for the Fifth Circuit was rendered on November 9, 1945, and has not yet been reported. (R. 269.) The opinion, consisting of only two paragraphs, appears as Appendix A to this petition.

The judgment below affirms the decision of the Tax Court of the United States, which is not reported. (R. 52, 96.)

JURISDICTION.

The judgment of the Circuit Court of Appeals for the Fifth Circuit was entered on November 9, 1945. (R. 270.) The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925. (28 U. S. C. A., Sec. 347.)

THE QUESTION PRESENTED.

Is Petitioner liable for income taxes on dividends on stock declared and paid in 1935, 1936 and 1937, notwithsatnding the fact that a State Court of competent jurisdiction, with the Petitioner and his wife and the Company before it, had decreed that Petitioner had in 1934 by valid and completed gift, without reservation, restriction or limitation, transferred the stock to his wife and that thereafter he had no interest in same?

STATUTES INVOLVED.

Revenue Act of 1934, c. 277, 48 Stat. 680:

"Sec. 11. Normal Tax on Individuals.

"There shall be levied, collected, and paid, for each taxable year upon the net income of every individual, a normal tax * * *."

"Sec. 12. Rate of Surtax on Individuals.

"(b) There shall be levied, collected, and paid for each taxable year upon the surtax net income of every individual, the surtax shown in the following table: * * *"

"Sec. 22. Gross Income.

"(a) *General Definition.*—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, or from professions, vocations, trades, businesses, commerce, or sales,

or dealings in property, whether real or personal, growing out of ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever * * *."

The corresponding provisions of the Revenue Act of 1936, c. 690, 49 Stat. 1648, are identical.

SPECIFICATION OF ERRORS TO BE URGED.

The Circuit Court of Appeals for the Fifth Circuit erred:

(1) In holding that Petitioner is liable for income taxes on dividends on stock notwithstanding the fact that a State Court of competent jurisdiction, with Petitioner and his wife and the Company before it, had decreed that Petitioner had, prior to the declaration and payment of such dividends, by valid and completed gift, without restriction, reservation or limitation, transferred the stock to his wife.

(2) In refusing to remand the cases to the Tax Court in order that the State Court decree might be introduced in evidence before that Court and the case decided by that Court in the light of the State Court decree.

(3) In failing to hold that the Tax Court, in concluding that the Petitioner retained such "dominion and control" as would defeat a gift, improperly confused with dominion and control in the husband those prerogatives exercised by a husband solely by reason of a continuing cordial marital relationship where the will of the donee is under no restraint and where actual dominion and control is vested fully in the wife. Cf. *Richardson* v. *Smith*, 102 F. (2d) 697.

STATEMENT OF THE CASE.

On October 11, 1944, the Tax Court held that Petitioner was liable for income taxes on dividends paid on certain stock during the years 1934, 1935, 1936 and 1937. The Tax

Court based its holding solely upon the premise that the Petitioner had not, as he contended, made a valid and completed gift of the stock to his wife in 1934. (R. 65.)

Subsequently, in February, 1945, the General Assembly of the State of Georgia enacted a Declaratory Judgment Act, whereupon suit was brought by the wife against Petitioner and the corporation paying the dividends.[1] In this suit a decree was rendered that, in 1934 (before the declaration of most of the dividends in question), Petitioner had made a valid and completed gift of the stock to his wife without any restriction, reservation, or limitation, and that Petitioner has at no time since had any right, title or interest in or to said stock.

Thereupon, Petitioner filed in the Circuit Court of Appeals his motion to remand to the Tax Court in order that Petitioner might there introduce in evidence the State Court decree and that the Tax Court might then determine, in the light of the State Court decree, the question of Petitioner's liability for income taxes for dividends paid. The Circuit Court denied Petitioner's motion, placing its denial squarely on the ground that the decree of the State Court determining the ownership of the stock in a suit between the parties is not binding for Federal income tax purposes.

The Commissioner did not urge, in the Circuit Court, that the State Court decrees were untimely and that, *for that reason,* the motions to remand should be denied. Likewise, the Circuit Court itself did not rest its decision upon the ground of the untimeliness of the State Court decrees. The Commissioner urged below, and the Circuit Court held, that the motions should be denied upon the broad ground that *a State court decree determining ownership cannot bind the*

[1] By an Act of the General Assembly of the State of Georgia, approved February 12, 1945 (Georgia Laws 1945, p. 137), Georgia courts were vested with jurisdiction to render declaratory judgments. Prior to the Act of 1945 the Georgia courts possessed no such jurisdiction. *Southern Railway Co.* v. *State of Georgia*, 116 Ga. 276. Because of this lack of jurisdiction, Petitioner could not have instituted proceedings for a declaratory judgment until after the decision of the Tax Court in 1944.

Tax Court and that the taxpayer was therefore liable for taxes on dividends on the stock, notwithstanding the State Court decree adjudging the stock to be the absolute property of the Petitioner's wife.[2]

The Commissioner also urged among other things in the court below that the decree of the State Court was, in effect, a consent decree and is for that reason to be denied any effect. The court below did not proceed upon any such theory and that is not an issue here in considering the correctness of the sweeping principle laid down by the court below.[3]

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[2] The effect of a decision based on the untimeliness of the State Court decree would be entirely different from the effect of a decision based on the broad ground that the State Court decree is not binding in any event. A decision based on the untimeliness of the State Court decree would not be binding in a suit involving the taxability of dividends for 1938 and subsequent years, whereas the decision of the court below may have this very serious consequence, notwithstanding that the Government seems prepared to admit that the State Court decree should affect the taxation of income subsequently realized. (Government Brief below, pp. 46, 47.)

[3] In his brief in the court below (p. 44), the Commissioner urged that, if the Court should consider the State Court decree material, the Commissioner would then be entitled to an opportunity in the Tax Court to challenge the circumstances under which the decree was obtained. This the Petitioner conceded, and Petitioner was prepared to show that the decree represents the considered judgment of the State Court, and that it was in no sense a consent decree. Even if the suit could be said to be "non-adversary", that was true of the decrees in the cases of *Helvering* v. *Rhodes' Estate,* 117 F. (2d) 509 (C. C. A. 8th), and *Eisenmenger* v. *Commissioner,* 145 F. (2d) 103, 107 (C. C. A. 8th), with which conflict is alleged, pages 8 and 9, *infra*. See also *Freuler* v. *Helvering,* 291 U. S. 35, and *Blair* v. *Commissioner,* 300 U. S. 5. An attack on this ground would challenge much of the solemn judicial proceedings of all lower State and Federal courts.

While perhaps this is not the place to pursue the matter further, it may be stated that the declaratory decree was entered in proceedings where the State Court, sitting without a jury, determined the issue of whether a valid gift of stock was effected in 1934 upon the fullest presentation of conflicting contentions. The State Court had properly before it (1) all evidence and briefs which were before the Tax Court in the present suit, and (2) all of the evidence just previously submitted before the same State

REASONS FOR GRANTING THE WRIT.

1. The decision below involves an important question of Federal tax law which the court below decided contrary to decisions of this court. The court below held that the judgment of a State Court having jurisdiction of the parties determining the ownership of property during the tax years in question is not binding on the Tax Court in determining to whom the income from the property is to be taxed. This Court has uniformly held that where a State court has settled the ownership of property, its judgment is binding upon taxing authorities where the question of the ownership of the property becomes material in a tax case. *Blair* v. *Commissioner*, 300 U. S. 5; *Freuler* v. *Helvering*, 291 U. S. 35.

Concededly, the interpretation of taxing statutes is a Federal question not controlled by the decision of a State Court But Federal taxing statutes have not superseded the function of the State Courts to determine the ownership of property in a suit between its citizens brought before such courts, and the decree of a State court with respect to the ownership of the property in litigation before it is final and conclusive of that question for Federal tax purposes as well as for other purposes.

In only one case has the doctrine laid down in the *Blair* and *Freuler* cases, *supra*, been challenged. In *Sharp* v. *Commissioner*, 91 F. (2d) 802, 803, 804 (C. C. A. 3rd), the

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Court in a sharply contested suit by First National Bank of Atlanta, as trustee, against the Sewell Manufacturing Company and Mrs. Ava F. Sewell. In the bank suit, the bank asserted, as does the Commissioner here, that the alleged gift in 1934 was not a valid completed gift and that the stock remained the property of the husband. It is apparent from the records in the State Court proceedings, which were before the court below (R. 214-241), and from the motion to remand (R. 183-190) that the proceedings in the State Court fully placed before that Court for its considered decision the question of the validity of the gift and the subsequent ownership of the stock.

Third Circuit Court of Appeals held that property, though held by the State Court decree to have been transferred by the decedent, was includible in the decedent's estate for tax purposes notwithstanding the State Court decree. This Court reversed the decision of the Third Circuit, *per curiam,* simply citing the *Blair* and *Freuler* cases. *Sharp* v. *Commissioner,* 303 U. S. 624.

While the language of the court below in the present case is not identical with that of the Third Circuit Court of Appeals in the *Sharp* case, it is significant that neither court cited an authority nor made any attempt to reason out the result reached or to justify the inconsistency of that result with the *Blair* and *Freuler* cases and that each court disposed of the question in one short paragraph and that each court apparently was oblivious of the fact that the decision rendered by it was in clear conflict with decisions of this Court and of other Circuit Courts of Appeals. The portions of the two opinions dealing with the State court judgments are set out in full in parallel columns in Appendix B hereto, page 20, *infra.*

It is worthy of note that the Government did not oppose the granting of the writ of certiorari in the *Sharp* case.[4] We do not see how it can well justify opposition to certiorari in the present case. Unless this Court is now prepared to depart from the principle laid down by it in the *Blair, Freuler* and *Sharp* cases, the judgments of the State Court must here be given like controlling effect, and the decision of the court below must be reversed. We assume that the Government would concede that, even if the principle laid down in the *Blair, Freuler* and *Sharp* cases is now to

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[4] The Solicitor General's memorandum brief on the merits in this Court in the *Sharp case* (No. 558, Oct. Term, 1937) concluded:

> "We, therefore, are of the opinion that the Board of Tax Appeals should have followed the decree of the State Court. But out of deference to the views of the Board and the Circuit Court of Appeals for the Third Circuit, the Government does not confess error. Instead, it is respectfully submitted for such disposition as the Court thinks meet."

be overturned, it should be by a decision of this Court, and not by a decision of a Circuit Court of Appeals which deals with the question only summarily, referring to none of the opinions of this Court or of other Circuit Courts of Appeals analyzing the problem.

2. The decision below is in conflict with decisions in the Eighth Circuit in which it was held that the judgment of a State court of competent jurisdiction with respect to the ownership of property is conclusive upon the Tax Court and upon courts to which the decision of the Tax Court is appealed. *Eisenmenger* v. *Commissioner*, 145 F. (2d) 103, 106, 107 (C. C. A. 8th); *Hubbell* v. *Helvering*, 70 F. (2d) 668, 669 (C. C. A. 8th); *Helvering* v. *Rhodes' Estate*, 117 F. (2d) 509, 510 (C. C. A. 8th). The Board of Tax Appeals itself has given like conclusive effect to a State court judgment determining the ownership of property. *Louise Savage Knapp*, 46 B. T. A. 846, 854; *James T. Pettus*, 45 B. T. A. 855, 861. The decision below is also in conflict with the decision of the Sixth Circuit in the case of *Nashville Trust Co.* v. *Commissioner*, 136 F. (2d) 148 (C. C. A. 6th), which holds to be binding upon the Tax Court a decree of a State court of competent jurisdiction that property received from an estate was received as compensation for services and not as a bequest.

Even if there be read into the sweeping principle laid down by the court below a limitation, not therein expressed, that the rule is applicable only to cases where, as here, the State court decree is based upon issues of fact rather than upon issues of State law, still the decision below would be in square conflict with decisions of the Eighth Circuit in *Helvering* v. *Rhodes' Estate*, *supra*, and of the Sixth Circuit in *Nashville Trust Co.* v. *Commissioner*, *supra*, in which it was held that a State court decree is conclusive, though based upon issues of fact and not upon issues of State law. In its brief in the court below the Government conceded that a de-

cision based upon this distinction would be in conflict with the *Rhodes' Estate* case, *supra*.[5]

3. If the decision below should be interpreted as holding that the decree of the State Court is binding upon the Tax Court on the question of ownership of the property, but that ownership does not determine taxability of the income from the property, the shocking nature of the decision and the importance of the question involved would obviously demand the granting of the writ.

Never before, so far as we are aware, has it been held that where one makes a valid and completed transfer of property, without restriction, reservation or limitation (as the State Court has here held to be the case), the transferor is liable for income subsequently received by the transferee from the property so transferred. We have been loath to believe that the court below intended, without analysis, discussion or citation of authority, to introduce into the law any such novel proposition. We have assumed rather that the decision was intended only to deny to the State Court judgment the force which the decisions of this Court and of other Circuit Courts of Appeals have attributed to such judgments *in determining ownership*.[6] If, however,

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[5] In its brief in the Court below the Government said (pp. 54-55):

> "With one exception, the other cases cited by the taxpayer may be dismissed with the observation that none of them appears to have held that a federal court must accord any weight to a state court judgment turning on a question of fact. That one exception is *Helvering* v. *Rhodes Estate*, 117 F. (2d) 509 (C. C. A. 8th), where the United States Circuit Court of Appeals for the Eighth Circuit affirmed the decision of the Board of Tax Appeals that the prior decree of a state court as to ownership of property should be given effect in determining the incidence of the federal estate tax, although the judgment turned on a question of fact. We think that the decision was erroneous."

[6] The language of the Third Circuit Court of Appeals in its opinion in the *Sharp* case, *supra*, suggests more strongly than the language of the court below an intention to lay down the broad

it stands for the more sweeping proposition, clearly certiorari should be granted.

CONCLUSION.

For the foregoing reasons, we respectfully submit that the petition for a writ of certiorari should be granted. It is believed that there has been shown a clear conflict of the decision below with the decisions of this Court and other

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proposition that complete legal ownership of property and taxability of the income therefrom may be divorced. Nevertheless, in the presentation of the *Sharp* case to this Court, the parties did not interpret the decision of the Third Circuit as involving this question; and this Court, in reversing the *Sharp* case *per curiam*, simply cited the *Blair* and *Freuler* cases. However, the language in the case of *Loggie* v. *Commissioner* (CCA 5, decided December 10, 1945, not yet reported, copied as Appendix C to this Petition, page 21, *infra*) again suggests an intention on the part of the Fifth Circuit to assert some such novel proposition.

The respondent in the court below did assert some such proposition, relying upon such cases as *Helvering* v. *Clifford*, 309 U. S. 331; *Harrison* v. *Schaffner*, 312 U. S. 579; *Helvering* v. *Horst*, 311 U. S. 112; *Helvering* v. *Stuart*, 317 U. S. 154; *Douglas* v. *Willcuts*, 296 U. S. 1; *Argo* v. *Commissioner*, 150 F. (2d) 67 (C. C. A. 5th) (cert. den. November 5, 1945); *Doll* v. *Commissioner*, 149 F. (2d) 239 (C. C. A. 8th) (cert. den. October 8, 1945). The Circuit Court in the *Loggie* case, *supra*, relies upon the first three of the cases just cited. None of these cases suggests that where, as here, one transfers property outright to another the grantor remains taxable on the income thereafter accruing from the property.

The present case presents no situation of a short term trust for the benefit of a wife, with reversion to the settlor-trustee, he being meanwhile vested with control over the res and vested with absolute discretion as to payment of income to the beneficiary. *Helvering* v. *Clifford*, *supra*. Nor does this case present a situation where a taxpayer makes an assignment of income certain shortly thereafter to be paid. *Harrison* v. *Schaffner*, *supra; Helvering* v. *Horst*, *supra*. Nor does this case present a situation of a trust by a husband to discharge legal obligations to a divorced wife or to children of the taxpayer, the taxpayer reserving extensive powers of control over the trust res and distribution of income. *Helvering* v. *Stuart*, *supra; Douglas* v. *Willcuts*, *supra*. Nor does this case present a situation of a family partnership where a husband makes his wife a partner in an enterprise, the income of which is earned by the husband's labor and, by virtue of the partnership arrangement, divided with his wife. *Argo* v. *Commissioner*, *supra; Doll* v. *Commissioner*, *supra*.

Circuit Courts of Appeals upon an important question of Federal tax law.

It seems appropriate, however, to discuss briefly in the following Brief in Support of Petition certain questions which may arise in the mind of the Court or may be raised by the Solicitor General, should he oppose the granting of the writ.

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